

IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO

DIVISION OF FINANCIAL MANAGEMENT

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After months of negative economic news, we have been treated to a wave of positive data recently. The U.S. Department of Commerce revised its estimate of 2001 fourth quarter real GDP growth from an anemic 0.2% to a relatively healthy 1.4%. This change caught many economists by surprise. Some were expecting the revised fourth quarter estimate to come in below the previous estimate. Even the optimists, who thought the 0.2% estimate was too low, were surprised with the size of the revision. As a result of this new data, many economists have changed their prognosis for the economy. Almost all agree the recession will be milder than had been thought just a few months ago. Some believe the recession is already over. And there is a growing camp of economists that question whether the economy even suffered a recession.

Other measures also lengthened the recession's epitaph. Consumer confidence rallied in early March to its highest level since December 2000. Consumer borrowing jumped 9.3% as Americans felt comfortable with taking on more debt. But rising confidence was not the sole reason for this change. Low interest rates also helped finance the borrowing jump. These rates should continue in the near future because inflation is unlikely to rise significantly. Prices are being held down by several factors. One of the most notable is low labor costs. Thanks to soaring nonfarm business productivity gains, unit labor costs actually dropped 2.7% recently. Even the battered manufacturing sector showed a signs it was emerging from its long funk, as the purchasing managers' index peeked above 50.

Perhaps the most encouraging news was that the unemployment rate fell for the second consecutive month. Specifically, it dropped from December 2001's 5.8% to 5.6% in January 2002 and 5.5% in February 2002. While these declines are small, they are significant. Traditionally, it takes longer for the

unemployment rate to fall after a recession. Of course, the falling unemployment rate could be a fluke caused by unusual seasonal conditions. But even if the decline is temporary, it is unlikely the unemployment rate will rise as much as had been previously forecast. Last fall DRI*WEFA projected the U.S. civilian unemployment rate would peak at 6.3% in third quarter of 2002. The apex of the unemployment rate has been scaled back to 6.1% in its February 2002 forecast.

With mounting evidence that the recession is near its end or has already ended, it is time to look forward to what the economic landscape will look like after the dust of this downturn settles. In particular, we would like to review how Idaho fares compared to the U.S. and other states as the nation's economy expands. Lest we are accused of being biased, we will use DRI*WEFA's Winter 2001 *Regional Forecast* instead of our own.

Idaho's economy has outperformed the national economy since the late 1980s. This was expected to continue during and after the recession. DRI*WEFA forecast U.S. nonfarm employment would contract just 0.1% this year and Idaho employment would expand 0.7%. Looking past this year, Idaho nonfarm employment should advance about 2.0% annually. In comparison, U.S. nonfarm employment should rise about 1.3% per year over this same period. DRI*WEFA believes Idaho will remain one of the 10 fastest growing states over the next few years. From the end of 2001 to the end of 2003, Idaho nonfarm employment is projected to rise 1.6% annually, which is the 5th fastest in the nation. From the end of 2003 to the end of 2006, annual Idaho nonfarm employment growth improves to 2.4% and it moves up to the second fastest growing state. Nevada is the employment leader.

Bonus Depreciation has arrived. A federal economic stimulus package

(H.R. 3090) received lightning-fast approval in early March as the 6-month anniversary of the 9/11 terrorist attacks approached. One provision, so-called "bonus depreciation," has the potential of seriously aggravating fiscal problems currently ravaging state budgets throughout the nation, including Idaho. Bonus depreciation refers to a 30% off the top depreciation allowance for most depreciable equipment placed in service between 9/11/2001 and 9/10/2004.

Preliminary estimates place the likely cost to Idaho at \$20-\$25 million per year for three years *if Idaho conforms to this federal change*. Idaho has the option of choosing to not conform to federal tax law on this issue, but the ramifications of such a decision are extremely complicated. It is also very likely that even if Idaho "decouples" from federal tax law on this issue, a considerable amount of revenue would nonetheless be lost. This is because decoupling would have Idaho forcing major national and international corporations (think GM, GE, IBM, Exxon, etc.) to follow our rules on this issue (essentially, separate depreciation schedules) for essentially all equipment purchases throughout the entire company.

As of this moment, Idaho has not officially adopted this federal tax provision and will not have an opportunity to do so until the next legislative session, presumably in January 2003.

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General Fund Update

As of February 28, 2002

Revenue Source	\$ Millions		
	FY02 Executive Estimate ³	DFM Predicted to Date	Actual Accrued to Date
Individual Income Tax	940.2	590.1	558.3
Corporate Income Tax	93.4	45.7	33.2
Sales Tax	659.4	447.6	446.7
Product Taxes ¹	20.6	13.9	14.1
Miscellaneous	110.6	51.4	53.3
TOTAL GENERAL FUND²	1,824.2	1,148.7	1,105.7

¹ Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
² May not total due to rounding
³ Revised Estimate as of January 2002

February General Fund revenue continued the recent trend of underperformance, albeit at a reduced pace. The \$6.7 million shortfall for the month brings the fiscal year to date gap to \$43.0 million. February's negative performance was dominated by the income tax (both individual and corporate), with favorable results from the other three major categories offsetting over a third of the income tax weakness.

Individual income tax collections were \$9.5 million lower than predicted in February, and are now \$31.8 million below the level expected for the fiscal year to date. February's weakness was due to a combination of higher-than-predicted refunds (\$6.6 million) and lower-than-expected withholding

collections (\$2.6 million). Filing payments were a mere \$0.1 million lower than expected in February. Interestingly, the excessive refunds in February are probably due to a major acceleration of refund processing that has occurred over the past several years. Applying a time trend to historic February refund payments yields a predicted value that is actually \$2.3 million **higher** than the actual refund payouts in February.

Corporate income tax collections were \$2.2 million lower than expected in February, and are now \$12.5 million lower than expected for the fiscal year to date. February's weakness was primarily the result of estimated payments that were \$2.7 million below the predicted amount. Corporate refunds

were \$0.7 million lower than expected.

Sales tax collections were \$1.4 million higher than expected in February, bringing year to date sales tax collections to within \$1 million of the predicted amount.

Product taxes were \$0.2 million higher than expected in February due to strong cigarette tax collections. Miscellaneous revenue was \$3.3 million higher than expected for the month, and is now \$1.9 million above the year-to-date predicted amount. February's strength came primarily from interest earnings that were \$2.4 million higher than expected.